

Message Text

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ACTION EB-07

INFO OCT-01 NEA-10 ISO-00 SP-02 AID-05 NSC-05 CIEP-01

TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00 COME-00

FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 LAB-04

SIL-01 FEA-01 ERDA-05 DODE-00 FPC-01 H-02 INT-05 L-03

PM-03 SAM-01 OES-03 PA-01 PRS-01 /104 W

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R 180800Z JUN 75 ZFG

FM AMEMBASSY ABU DHABI

TO SECSTATE WASHDC 3049

INFO AMEMBASSY BEIRUT

AMEMBASSY DOHA

AMEMBASSY JIDDA

AMEMBASSY KUWAIT

AMEMBASSY MANAMA

AMEMBASSY MUSCAT

AMEMBASSY TEHRAN

C O N F I D E N T I A L ABU DHABI 1295

DEPARTMENT PASS TREASURY, FEDERAL RESERVE

E.O. 11652: GDS

TAGS: EFIN, ECIN, TC

SUBJ: UNIFIED CURRENCY FOR GULF STATES

REF: ABU DHABI 1276

1. ACCORDING TO UAE CURRENCY BOARD DIRECTOR, KUWAIT PRIME MINISTER JABIR AL-AHMED LAST MONTH SECURED AGREEMENT OF BAHRAIN, QATAR AND UAE TO ESTABLISHMENT OF MONETARY UNION. IDEA HAS BEEN BANDIED ABOUT IN GULF FOR SOME TIME, BUT VISIT OF AL-AHMED GAVE CONCEPT OF GULF DINAR RENEWED POLITICAL MOMENTUM. UAE POLITICAL LEADERS ESPECIALLY RECEPTIVE TO MONETARY UNION AND COMMON CURRENCY PERHAPS BECAUSE THEIR
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EXPERIENCE WITH OLD GULF RUPEE STILL FRESH IN THEIR MEMORY.

WITH SURPRISING RAPIDITY, CENTRAL BANK REPS MET IN ABU DHABI FOR TWO DAYS (REFTEL) TO DISCUSS TECHNICAL DETAILS. KUWAIT DELEGATION WAS UNDER INSTRUCTION TO SEEK IMPLEMENT COMPLETE MONETARY UNION WITHIN THREE MONTHS. CENTRAL BANK REPS MORE REALISTIC THAN POLITICAL LEADERSHIP AND THIS REALISM REFLECTED IN THEIR REPORT. REPORT, RECOMMENDATIONS AND SCHEDULE FOR IMPLEMENTATION WILL BE SUBMITTED TO RESPECTIVE HEADS OF STATE FOR FINAL APPROVAL FOLLOWED BY ANOTHER MEETING OF CENTRAL BANKERS IN KUWAIT THIS OCTOBER.

2. REPORT OUTLINES QUITE CLEARLY ECONOMIC AND POLITICAL IMPLICATIONS OF MONETARY UNION, ESPECIALLY NEED FOR ONE CENTRAL MONETARY AUTHORITY AND POLITICAL COMMITMENT TO ENFORCE AUTHORITY'S DECISION. RATHER THAN GO THE WHOLE ROUTE, CENTRAL BANKERS HAVE RECOMMENDED HALF-LOAF: ISSUANCE OF A COMMON CURRENCY TO CIRCULATE FREELY AS A MEANS OF PAYMENT AMONG PARTICIPATING STATES WITH QUARTERLY MEETING TO COORDINATE MONETARY AND FISCAL POLITICIES. SCHEME WOULD BE IMPLEMENTED WITHIN TWO YEARS.

3. NEW GULF DINAR WOULD BE PEGGED TO SDR'S, A BLOW TO THE KUWAITIS WHO WANTED OTHER GULF STATES TO REVALUE OR DEVALUE AND LINE UP WITH THE DINAR. NEITHER BAHRAIN NOR UAE ARE WILLING TO DO SO, THEREFORE GULF DINAR NOTES WOULD EXCHANGE AT RATE PREVAILING BETWEEN GIVEN NATIONAL CURRENCY AND SDR. NEW NOTES WOULD ALSO BE COLOR KEYED BY PLACE OF ISSUANCE (E.G. KUWAIT RED, BAHRAIN BLUE, ETC.) ALLOWING MONETARY AUTHORITIES TO EASILY KEEP TRACK OF CAPITAL FLOWS.

4. IN ESSENCE, PARTICIPANTS HAVE AGREED TO REGIONAL FIXED EXCHANGE RATES WITH ISSUANCE OF COMMON CURRENCY AS SO MUCH WINDOW DRESSING. COMMON CURRENCY WOULD INDEED FACILITATE SETTLEMENT OF REGION'S MULTILATERAL CLAIMS NOW DONE IN DOLLARS AND STERLING THROUGH FINANCIAL CENTERS OF INDUSTRIAL WORLD. VELOCITY OF MONETARY CIRCULATION WOULD INCREASE, FREEING DOLLAR RESERVES FOR EXTERNAL USE AND ALLOWING INCREASED DOMESTIC TRANSACTIONS. SAME RESULTS PROBABLY COULD HAVE BEEN ACHIEVED THROUGH ESTABLISHMENT OF REGIONAL CLEARING HOUSE.

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5. DESPITE PUBLIC BALLYHOO IN UAE PRESS, UAE NEGOTIATORS SEE NUMBER OF POTENTIAL PITFALLS AHEAD. THESE PROBLEMS NEED NOT NECESSARILY BE RESOLVED PRIOR TO ISSUANCE OF NEW CURRENCY AS LONG AS POLITICAL LEADERS ARE PREPARED TO LIVE WITH THE CONSEQUENCES. ONE POINT IN PARTICULAR IS QUESTION OF FOREIGN BANK OPERATIONS. UAE NOW HAS OVER 30 FOREIGN BANKS, MOST OF THEM AWASH IN DIRHAM LIQUIDITY AND COMPLAINING OF DEARTH OF LEADING OPPORTUNITIES IN UAE PRIVATE SECTOR. NEW CURRENCY

MEANS ALL BANKS IN PARTICIPATING STATES HILL HAVE SAME DEPOSIT BASE AND AT LEAST THEORETICALLY SHOULD BE ALLOWED TO LEND IN COMMON CURRENCY AREA. WILL KUWAIT ALLOW UAE BANKS TO DO SO? POLITICALLY, QATAR SHOWED SOMETHING LESS THAN ENTHUSIASM TO KUWAITI INITIATIVE AND COULD IN FUTURE REFUSE TO COOPERATE TO THE EXTENT REQUIRED TO MAKE SCHEME A SUCCESS. UAE HAS ALREADY BEEN IN TOUCH WITH SAMA AND THEY ALSO VERY RELUCTANT TO PARTICIPATE.

6. CURRENCY BOARD SOURCE ADMITS KUWAIT THINKING ON FINANCIAL AFFAIRS PROBABLY FIFTEEN YEARS AHEAD OF OTHER GULF STATES. BUT THAT FIFTEEN-YEAR VIEW NOT SO ROSY, ACCORDING TO THIS SOURCE. DESPITE YEARS OF FINANCIAL EXPERIENCE KUWAIT BEGINNING TO FEEL COMPETITION FROM LOWER GULF. UAE AUTHORITIES HAVE STAUNCHLY RESISTED DIRHAM REVALUATION, INSPIRING THE CONFIDENCE OF BORROWERS. ABOUT 150 MILLION DOLLARS OF DIRHAM PRIVATE PLACEMENTS WERE MADE IN 1974. OVER THE LONG RUN, THE DIRHAM COULD PROVE MORE ATTRACTIVE TO BORROWERS THAN KUWAIT DINAR, THANKS TO KUWAITI BANKING RESTRICTIONS. REGIONALLY, CAPITAL IS FLOWING OUT OF KUWAIT BECAUSE OF INTEREST RATE DIFFERENTIALS. KUWAIT THUS LOSING PROMINENCE AS GULF FINANCIAL CENTER AND PUSH TO CREATE COMMON CURRENCY BELIEVED HERE TO BE MEANS FOR RE-ASSERTING THAT PROMINENCE.
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